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In the Supreme Court of the United States

OCTOBER TERM, 1987

MERCEDES-BENZ OF NORTH AMERICA, INC., PETITIONER

v.

METRIX WAREHOUSE, INC. AND
CARL SCHWARTZ, RESPONDENTS

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

We showed in the petition that the Fourth Circuit has decided an antitrust issue of substantial practical importance in a manner that conflicts with the decisions of this Court and other courts of appeals and with current antitrust scholarship. Metrix has responded by misstating the holdings and even the chronology of prior cases in an effort to erase their precedential value, by ignoring the important distinctions between distributional and end-user vertical restraints, by dismissing unrefuted evidence of consumer expectations as merely "anecdotal," and by equating free-riding with competition on the merits. Because Metrix's anachronistic approach to antitrust law reflects the approach employed by the Fourth Circuit, further review is plainly warranted.

1. Metrix's principal argument in the brief in opposition is that "[t]he legitimate business purpose defense to *per se* illegality in tie-in cases is . . . exceedingly narrow" and can only be established if there are no "less restrictive alternatives." Br. in Opp. 12-13. That sweeping assertion rests on a misunderstanding of this Court's early tie-in decisions and a studious avoidance of the Court's most recent pronouncements on tie-ins and other vertical nonprice restraints. As a result, Metrix's strenuous efforts to square the decision below with *Pick Mfg. Co.* v. *General Motors Corp.*, 299 U.S. 3 (1936), are unavailing.

a. This Court first applied the "less restrictive alternative" formula to a business justification defense in *International Business Machines Corp.* v. *United States*, 298 U.S. 131 (1936), a case that also delineated the bounds of the goodwill or business justification doctrine. See *Times-Picayune Pub. Co.* v. *United States*, 345 U.S. 594, 607 (1953). According to Metrix, this Court's decision in *Pick* "predated" the *IBM* case (Br. in Opp. 16) and thus should be disregarded as "a pre-goodwill doctrine case [that failed to survive] the evolution of tying law" (*ibid.*). But Metrix is plainly mistaken about both

the chronology of these cases and the relevance of *IBM* in the present context.

To begin with, *Pick* did *not* predate *IBM*: this Court announced its decision in *IBM* on the same day that it granted certiorari in *Pick*. 298 U.S. 648 (1936). Moreover, the decision in *IBM* was expressly limited to tie-ins "whose substantial benefit to the [defendant] is the elimination of business competition and the creation of monopoly, rather than the protection of its good will, and where it does not appear that the latter cannot be achieved by methods which do not tend to monopoly and are not otherwise unlawful." 298 U.S. at 140. In so limiting its analysis in *IBM*, this Court cited the Seventh Circuit's decision in *Pick* (*ibid.*), and, at the same time that it handed down its decision, it granted certiorari in *Pick* as the first step toward its affirmance of the Seventh Circuit's ruling sustaining a manufacturer's ancillary restraint in the area of automobile replacement parts.

Thus, contrary to Metrix's contention, the *IBM* case is fully consistent with *Pick*. Furthermore, *IBM* fails to support the decision below for yet another reason that Metrix ignores: unlike *Pick* and the present case, *IBM* involved a tie-in imposed on the end-user of the product in question. Tie-ins restraining middlemen, as contrasted to consumers, have a markedly different impact on the goodwill of the respective manufacturers. A user of IBM machines who knowingly utilized nonconforming tabulating cards could not reasonably blame IBM if the cards caused the machine to malfunction. By contrast, a Mercedes-Benz dealer who utilizes nonconforming replacement parts causes consumers *unknowingly* to assume the risk and to blame the manufacturer if their cars malfunction.

b. Unable to discredit *Pick* by relying on *IBM*, Metrix next asserts (Br. in Opp. 19-20) that *Pick* is factually distinguishable. First, Metrix claims that "*Pick* was decided at a time of a fledgling automotive industry in 1936" (*id.* at 19). In fact, however, the record in *Pick*

showed that by 1932 there were approximately 47,000 franchised automobile dealers (15,000 of which sold GM products), 5,000 independent suppliers of parts, and 200,000 garages that repaired the 20 million cars then on the road. Br. of Petitioner in *Pick* at 9-10. Second, Metrix claims (Br. in Opp. 20) that "the plaintiff [in *Pick*] never contended that its parts were either the same as or met the specifications of GM parts." Again, Metrix is simply wrong. In fact, the plaintiff in *Pick* proved that GM dealers were not even permitted to install parts *manufactured by GM subsidiaries* unless those parts had been purchased by the dealers directly from GM. Br. of Petitioner in *Pick* at 11-12. In sum, as the district court correctly concluded, "[t]he material facts in this case are virtually identical to those in *Pick*." Pet. App. 35a.

c. Nor is Metrix correct in contending that *Pick* may be disregarded because of "dramatic turns in the course of antitrust law" (Br. in Opp. 16). To the contrary, this Court's recent decisions in the field of vertical restraints are fully consistent with *Pick*. Cases such as *Continental T.V., Inc.* v. *GTE Sylvania*, 433 U.S. 36, 54-58 (1977), recognize that vertical nonprice restrictions on middlemen permit "the manufacturer to achieve certain efficiencies in the distribution of his products," including the provision of "service and repair facilities," preservation of the "manufacturer's goodwill and the competitiveness of his product," and avoidance of "market imperfections such as the so-called 'free rider' effect." Accordingly, this Court's recent cases have declined to subject such vertical restraints to hostile scrutiny under a "less restrictive alternative" rationale. See *id.* at 58 n.29.

Although Metrix ignores the critical difference between vertical restraints on middlemen in the chain of distribution and restraints on consumers, and therefore overlooks the fundamental difference between *Pick* and *IBM*, members of this Court have frequently noted this distinction. In *Fortner Enterprises, Inc.* v. *United States Steel*

Corp., 394 U.S. 495, 514 n.9 (1969), for example, Justice White, dissenting on other grounds, observed that tying may be procompetitive and justified when it "protect[s] the reputation of the tying product if failure to use the tied product in conjunction with it may cause it to misfunction." In illustration of this point, Justice White contrasted *IBM* and *Pick*. *Ibid.* Likewise, in their concurring opinion in *Jefferson Parish Hosp. Dist.* v. *Hyde*, 466 U.S. 2, 41 (1984), Justice O'Connor, Chief Justice Burger, Justice Powell, and Justice Rehnquist cited the "economic benefits" of tie-ins in certain distribution contexts and reiterated the comparison of *IBM* and *Pick* employed by Justice White in *Fortner*.

These recently drawn distinctions between *IBM* and *Pick* cannot, as Metrix suggests, be dispatched as "dubious" antitrust analysis. Br. in Opp. 17. Rather, these opinions from members of the Court, considered together with earlier citations to *Pick* in *Times-Picayune*, 345 U.S. at 607, and *Standard Oil Co. of California* v. *United States*, 337 U.S. 293, 308 (1949) ("*Standard Stations*"), flatly refute Metrix's statement that "[t]his Court has never regarded its affirmance in *Pick* as standing for anything more than the general rule that upholds the findings of two lower courts unless clear error is shown." Br. in Opp. 17.

2. Perhaps the most striking aspect of the brief in opposition is its lack of contact with contemporary antitrust precedent and scholarship. To cite just a few examples:

- Metrix offers the outmoded view that an automobile distributor enjoys "appreciable market power" if, as a result of a car's "history, status, reputation and prestige" (Br. in Opp. 3), a scant 1% of the consuming public decides to purchase it.

- Without so much as a citation to *GTE Sylvania*, Metrix reasons that "free riding"—whether on the franchisor's warranty or the franchisees' collective goodwill—is of no antitrust concern. Br. in Opp. 22.

- Metrix simply ignores this Court's admonition in *NCAA* v. *Board of Regents*, 468 U.S. 85, 104 n.26 (1984)—that it is "inappropriate to condemn" an alleged tie-in without "considerable" inquiry into its "procompetitive justifications"—on the theory that "*Standard Stations* explicitly rejected an evaluation of the procompetitive effects of tie-in agreements." Br. in Opp. 22 n.5.

- And finally, Metrix summarily dismisses the views of leading antitrust scholars—often adopted by this Court—as little more than "various books and law review articles" that "lack precedential value." Br. in Opp. 21.

Given these erroneous and archaic premises, it is hardly surprising that Metrix ultimately reaches an insupportable conclusion: in Metrix's view (and the view of the Fourth Circuit), if a distributional restraint on automobile dealers can be labelled as a "tie-in," then it may not be upheld, *even in the total absence of anticompetitive impact on consumers*, unless there are no "alternatives" less restrictive of the freedom of generic parts distributors (Br. in Opp. 14-15)—even where, as here, commercial bribery is "standard" among those businessmen (*id.* at 5, quoting Pet. App. 26a). In short, Metrix's myopic view of the law of vertical restraints begins with *IBM*, ends with *Standard Stations*, excludes *Pick*, ignores *Sylvania*, and utterly overlooks the teaching of contemporary antitrust scholarship.

3. Metrix also is wrong in attempting to defend the Fourth Circuit's invalidation of MBNA's distributional restraint as a "practical assessment of alternatives to the tying arrangement." Br. in Opp. 22. The court of appeals' scavenger hunt for alternatives was in no way "practical." For example, the Fourth Circuit's "alternative" of stamping parts with MBNA's numbers was not even presented to the jury. Thus, franchisors seeking to defend distributional restraints cannot prevail if an appellate court can *imagine* a less restrictive alternative. Furthermore, the "alternative" of stamping parts was,

in fact, MBNA's long-standing practice. Unfortunately, Metrix's parts were similarly stamped and, as a result, the stamping was *not* a feasible alternative means of addressing MBNA's legitimate concerns about warranty fraud. By the same token, the suggested "alternative" of providing specifications was an existing MBNA practice as well—but a practice that could not assure that manufacturers faithfully met the specifications or that dealers who sold nongenuine parts had the ability or the incentive to determine whether those parts met the specifications.

But the principal defect in the Fourth Circuit's less restrictive alternative approach, and of Metrix's argument in support of that approach, is that it is premised on the fanciful notion that the 35,000 complex component parts of MBNA's automobiles are little different from the paper cups or plastic spoons sold by McDonald's franchisees—that is, that the franchisor can simply specify a grade or quality, rely on the franchisee to carry only that grade or quality, and not suffer significant harm if the franchisee fails to do so. Automobile replacement parts, however, are not paper napkins. Thus, the problem with the least restrictive alternative test applied by the Fourth Circuit is that it lends itself to a sterile, hypothetical analysis, divorced from the realities of the marketplace in which the restraint arises. For that reason, as we explained in the petition (at 16-19), it is out of step with the realistic economic approach followed in this Court's recent decisions.

4. Metrix nonetheless argues that this case is not worthy of review because it presents only "narrow issues" (Br. in Opp. 8), does not involve any "important questions" (*id.* at 10), and is nothing more than a fact-bound affirmance of a jury's findings (*id.* at 8-10). Metrix suggests that resolution of the issues presented by the petition therefore would have little, if any, general applicability or impact beyond the parties themselves.

This assertion is implausible on its face. The issues are of substantial concern to all franchisors and franchisees,

many of whose agreements contain nonprice restraints intended to protect the goodwill of the parties or to serve other unquestionably valid business justifications. Indeed, Metrix itself concedes the economic importance of the questions presented by remarking that a decision here would have a substantial impact on the $543 billion franchise distribution industry. Br. in Opp. 15. Moreover, this area of the law is marked by substantial confusion. *Pick* is on all fours with this case, has never been overruled by this Court, and has been cited by the Court and its members on numerous occasions. Yet Metrix contends, and the Fourth Circuit agreed, that *Pick* is a dead letter.

This confusion and uncertainty has real world consequences that cannot simply be swept under the rug. As Metrix grudgingly acknowledges (Br. in Opp. 20-21), within months of each other, the Fourth and Ninth Circuits reached diametrically opposite results on the identical question of whether Section 9(C) of MBNA's franchise agreement violates the antitrust laws. See *Mozart Co.* v. *Mercedes-Benz of North America, Inc.*, 833 F.2d 1342 (9th Cir. 1987). As the *amici curiae* brief filed by The Automobile Importers of America and The Motor Vehicle Manufacturers Association explains, it is imperative that this Court grant certiorari to rectify this intolerable situation (Motion For Leave To File Brief As Amici Curiae at 3):

> The decision below exposes automobile manufacturers and distributors to legal uncertainties that threaten to chill their efforts to develop and maintain the efficient and dependable dealership service networks so crucial to their business. This confusion is underscored by a subsequent decision of the Ninth Circuit upholding a jury verdict that found the same restriction to be legally justified by the very same commercial considerations that had been brushed aside in the jury verdict upheld by the Fourth Circuit.

But perhaps the best evidence contradicting Metrix's current denigration of the importance of the questions presented is provided by the record in the Fourth Cir-

cuit, which reveals that four separate trade associations filed *amicus curiae* briefs in support of Metrix on the ground that the legal issues have substantial and general importance. Typical of these *amicus* briefs was that of the American Service Industry Association, which made the following observation regarding the significance of this case:

> The issues in the matter before this court have consequences far beyond the particular effect on one vehicle manufacturer and on one warehouse distributor. Judicial pronouncements of the law do not stand in a vacuum. A decision in this case impacts not only on the basic competitive status of the Appellant and Appellee but also impacts on the basic competitive status of the entire [automobile parts] aftermarket in that it can produce a signal to all other vehicle manufacturers on the judgment of this Court as to the competitive consequences of tying arrangements in the automobile aftermarket.

Similar views appear in the *amicus* briefs of The Automobile Warehouse Distributors Association, The Automotive Parts & Accessories Association, and The Motor and Equipment Manufacturers Association. Thus, the general importance of the questions presented is not open to serious dispute.

5. Metrix argues (Br. in Opp. 7-8) that, despite the glaring defects and practical importance of the decision below, review at this time would be "premature" because the decision is "interlocutory." This argument is unpersuasive for several reasons.

First, the Fourth Circuit's ruling—which distinguishes *Pick* into oblivion and requires proof of no less restrictive alternatives for MBNA's ancillary distributional restraint—is final. Nothing that might occur on remand can alter that holding or eliminate its harmful economic effects. Second, no further proceedings would be required on remand if this Court were to grant certiorari and reverse. Indeed, the courts below granted interlocutory appeal in this case—which has been pending for nearly a decade—precisely because "the *Pick* issue is dis-

positive of [Metrix's] Sherman Act claim" and because its resolution will materially advance the ultimate termination of the litigation. See Pet. App. 36a, 39a, 41a. Third, even if Metrix's contention were correct, that would not be a reason to deny certiorari. This Court has not hesitated to grant review of important and unresolved antitrust issues, even though the judgment below was interlocutory. See, *e.g.*, *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 107 S. Ct. 3182 (1987); *Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 106 S. Ct. 1348 (1986).

6. Metrix makes a number of false or misleading statements that should not go unanswered. It states (Br. in Opp. 5, 17) that MBNA argues for a so-called "Automobile Exception" to tie-in law. MBNA *never* made that argument below and does not present it here. MBNA's position is, and always has been, that the business justification defense may be satisfied without proof of the absence of hypothetical less restrictive alternatives and that *Pick* establishes one set of facts in which the defense has been found to exist.

Next, Metrix asserts (Br. in Opp. 22) that "most of Metrix's parts are identical to [MBNA's] parts." This, too, is incorrect. Aside from the fact that DBAG's extensive quality control program often creates a physical difference in the parts, *no* Metrix part is the same as an MBNA part because only the latter *legitimately* carries the warranty and reputation of MBNA and Daimler-Benz.

Metrix also claims (Br. in Opp. 15) that MBNA's dealers are "the largest and most constant sources of M-B replacement parts available to consumers." In fact, MBNA dealers annually perform less than one-third of the nonwarranty repairs (and presumably install less than one-third of the parts) on Mercedes-Benz automobiles. That share has been decreasing every year. By far the greater number of repairs and parts installations are performed by independent garages, which outnumber MBNA dealers by ten to one. Pet. 24.

Finally, Metrix misrepresents MBNA's evidence of warranty fraud and consumer expectation (Br. in Opp. 23-24). With respect to warranty fraud, MBNA offered the *undisputed* testimony of three witnesses that dealers submitted fraudulent warranty claims to MBNA on parts MBNA did not sell. C.A. App. 744-49, 1517; R. 2577. One of these witnesses testified that fraudulent claims were submitted in his territory as often as "three, four, five times a month . . . ." C.A. App. 1517. With respect to consumer expectation, MBNA's "anecdotal" evidence (C.A. App. 1258-59, 1514-16, 1518, 1566-67, 1793, 1826, 2223, 2311, 2355-56, 2365-67) was corroborated by *uncontroverted* evidence of independent market surveys. C.A. App. 1325, 2219-20. These studies proved the common-sense proposition that Mercedes-Benz owners expect to receive genuine Mercedes-Benz parts when they patronize Mercedes-Benz dealers. C.A. App. 1325.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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